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Central Intelligence Agency

Washington, D.C. 20505

17 January 1986

MEMORANDUM FOR: Mark Linton
Office of Monetary Affairs
US Department of State

FROM : Chief, Regional East-West Economic Branch
East European Division
Office of European Analysis

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SUBJECT : Support for Paris Club Meeting on Poland

1. Attached is our response to your request for support in preparation for the Paris Club meeting on Poland. Attachment 1 consists of a series of six tables that summarize three possible outcomes for Polish debt, along with analysis of how sensitive each outcome is to changes in interest rates (LIBOR) and export earnings. Note that the data in these tables reflect substantial refinements beyond the material you received on 8 January. In particular, I want to call your attention to the optimistic scenario using Polish estimates. The Poles, as pointed out in this attachment, have been inconsistent in reporting their export plans. The following is a list of the tables included in Attachment 1:

Table 1: Payments Due to Creditors: Baseline Scenario (CIA estimates).

Table 2: Sensitivity Analysis using Baseline Scenario: The effect of changes in LIBOR and export earnings on total debt and financing gaps (CIA estimates).

Table 3: Payments Due to Creditors: Baseline Scenario with Annual Reschedulings (CIA Estimates).

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Table 4: Sensitivity Analysis using Baseline Scenario with Annual Reschedulings: The effect of changes in LIBOR and export earnings on total debt and the amounts of debt relief needed to close the financing gap (CIA Estimates).

Table 5: Payments Due to Creditors: Optimistic Scenario (Polish estimates).

Table 6: Sensitivity Analysis using Optimistic Scenario: The effect of changes in LIBOR and export earnings on total debt and financing gaps (Polish estimates). [redacted] 25X1

2. We also have included in Attachment 2 a figure showing the level of debt generated by the baseline scenario (Table 1), and an article assessing Polish export potential. The figure illustrates how an extremely small change in LIBOR and export performance eventually has a substantial impact on the level of gross debt. The article analyzes the potential for Polish hard currency exports to grow both from a demand and a supply perspective. [redacted] 25X1

3. I hope this information will prove useful to your needs. If you have any questions concerning this work, [redacted]

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Attachments:
As Stated

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Attachment 1

Comments Concerning the Scenarios and Polish Export Projections

1. We use the term Total Due to Unspecified Creditors to show obligations arising from new credits and future financing gaps that will either go into arrears or be rescheduled. We do not allocate these amounts to specific creditor groups (banks, governments, or other) because this will depend on Warsaw's decision about which groups to pay and on which groups will provide new credits and debt relief. The amounts shown as being due to specific creditor groups are those owed under the original loan contracts or already concluded rescheduling agreements. 25X1

2. All tables incorporate the rescheduling of the 1982-84 arrears and the 1985 Paris Club rescheduling. 25X1

3. We have made the following estimates concerning new credits for the baseline scenerio:

1986: $200 million - government, banks, and other creditors.
$ 90 million - first tranche of IMF credit.

1987: $200 million - government, banks, and other creditors.
$350 million - IMF.
$100 million - IMF, compensatory financing facility.

1988-90: $200 million annually - goverment, banks, and other creditors.
$350 million annually - IMF.
$400 million annually - World Bank (based on Yugoslavia's experience).

4. The Poles have announced several conflicting projections of 1986 hard currency export plans in the last two months--one for public consumption, the other for the benefit of the creditors:

--a report on the 1986 plan in the 6 December issue of the newspaper Polityka announced exports to the West would increase by only 3.8 percent.

--Manfred Gorywoda, chairman of the Planning Commission, said at a 20 December Central Committee Plenum that hard currency exports would increase by 5 percent.

--the Polish hard currency export target presented to the creditors in December 1985 was 9.2 percent.

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--the 1986-90 plan projects a 7 percent annual growth of exports to the West.

The Poles do not specify why the projected increases differ, but it could result from the use of different 1985 bases, either customs or payments data. [redacted]

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TABLE 1
POLAND: PAYMENTS DUE TO CREDITORS IN MILLION US DOLLARS AS OF 1/13/86
SCENARIO: BASELINE (CIA ESTIMATES)

Years	Terms	1985	1986	1987	1988	1989	1990
TOTAL PAYMENTS DUE TO CREDITORS		3093	6856	10765	16169	21177	25570
TOTAL PRINCIPAL DUE		549	2659	2928	4450	3942	2757
TOTAL INTEREST DUE		2545	2694	2871	3244	3698	4311
TOTAL ARREARS		0	1503	4966	8475	13537	18502
TOTAL DUE TO GOVERNMENTS		1032	3228	2519	2543	2628	3139
Principal		0	1290	1229	1218	1320	1912
Interest		1032	1428	1290	1326	1309	1227
Arrears		0	510	0	0	0	0
TOTAL DUE TO BANKS		1349	1670	1950	3423	2751	949
Principal		325	877	1195	2786	2320	653
Interest		1025	793	755	638	431	297
TOTAL DUE TO OTHERS		712	864	869	816	664	487
Principal		224	492	504	447	302	112
Interest		488	372	365	369	362	375
TOTAL DUE TO UNSPECIFIED CREDITORS		0	1095	5427	9386	15134	20996
Principal		0	0	0	0	0	80
Interest		0	102	460	911	1597	2413
Arrears		0	993	4966	8475	13537	18502
TOTAL FINANCING GAP		993	4966	8475	13537	18502	22850
Of which unpaid interest*		445	804	581	612	1024	1591
TOTAL PAYMENT CAPACITY		2100	1890	2290	2632	2675	2720
I)EARNED		1700	1500	1540	1582	1625	1670
a) Trade Balance		1000	1000	1040	1082	1125	1170
Exports**		5620	5800	6032	6273	6524	6785
Imports**		4620	4800	4992	5192	5399	5615
b) Services and Tranfers, net (excluding interest)		600	400	400	400	400	400
c) Interest Earnings		100	100	100	100	100	100
II)BORROWED***		400	390	750	1050	1050	1050
a)New Credits (Medium & Long Term)		200	290	650	950	950	950
b)Short Term Credits & Recycled Interest, Net		200	100	100	100	100	100
TOTAL DEBT	28200	29045	30239	31570	33232	35305	37947
Of which new borrowed		400	790	1540	2590	3640	4690
Libor Rate		8.5%	6.8%	7.5%	8.6%	9.4%	10.4%

Footnotes:
* Negative values for unpaid interest equal the extent to which payment capacity exceeds interest due and can be applied to repayments of principal.
** Exports and Imports are estimated to grow by 4 percent beginning in 1987.
*** Terms for the repayment of new borrowings were assumed to be a 5 year grace and a 5 year principal repayment period.

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TABLE 2
SENSITIVITY ANALYSIS, MILLION US DOLLARS AS OF 1/13/86
SCENARIO: BASELINE (CIA ESTIMATES)

Years	1985	1986	1987	1988	1989	1990
TOTAL DEBT*						
Baseline LIBOR	29045	30239	31570	33232	35305	37947
Baseline LIBOR + 1%	29045	30533	32205	34257	36796	39998
Baseline LIBOR + 2%	29045	30826	32846	35301	38328	42126
Baseline LIBOR + 3%	29045	31120	33492	36365	39904	44333
FINANCING GAP*						
Baseline LIBOR	993	4966	8475	13537	18502	22850
Baseline LIBOR + 1%	993	5260	9110	14562	19993	24901
Baseline LIBOR + 2%	993	5554	9750	15607	21525	27029
Baseline LIBOR + 3%	993	5847	10397	16670	23101	29237
AMOUNT OF ADDITIONAL DEBT OR GAP						
Between LIBOR & LIBOR + 1%	0	294	635	1025	1491	2051
Between LIBOR + 1% & LIBOR + 2%	0	294	641	1044	1533	2128
Between LIBOR + 2% & LIBOR + 3%	0	294	647	1064	1575	2208
TOTAL DEBT **						
Baseline Export Projection	29045	30239	31570	33232	35305	37947
Baseline Export Projection + 1%	29045	30183	31392	32855	34636	36871
Baseline Export Projection + 2%	29045	30127	31213	32473	33954	35769
Baseline Export Projection + 3%	29045	30070	31033	32086	33259	34639
FIANANCING GAP**						
Baseline Export Projection	993	4966	8475	13537	18502	22850
Baseline Export Projection + 1%	993	4910	8297	13160	17833	21775
Baseline Export Projection + 2%	993	4854	8118	12778	17151	20672
Baseline Export Projection + 3%	993	4798	7938	12391	16456	19542
AMOUNT OF ADDITIONAL DEBT OR GAP						
Between B.E.P. & B.E.P. + 1%	0	-56	-178	-377	-669	-1075
Between B.E.P. + 1% & B.E.P. + 2%	0	-56	-179	-382	-682	-1102
Between B.E.P. + 2% & B.E.P. + 3%	0	-56	-180	-387	-695	-1130

Footnotes:
* Assuming changes in LIBOR beginning in 1986.
** Assuming changes in export growth beginning in 1986.

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TABLE 3
POLAND: PAYMENTS DUE TO CREDITORS IN MILLION US DOLLARS AS OF 1/13/86
SCENARIO: BASELINE (CIA ESTIMATES) AND RESCHEDULING OF FINANCING GAPS

Years	Terms	1985	1986	1987	1988	1989	1990
TOTAL PAYMENTS DUE TO CREDITORS		3093	5863	5799	7694	7640	7267
TOTAL PRINCIPAL DUE		549	2659	2928	4450	3942	2955
TOTAL INTEREST DUE		2545	2694	2871	3244	3698	4311
TOTAL ARREARS		0	510	0	0	0	0
TOTAL DUE TO GOVERNMENTS		1032	3228	2519	2543	2628	3139
Principal		0	1290	1229	1218	1320	1912
Interest		1032	1428	1290	1326	1309	1227
Arrears		0	510	0	0	0	0
TOTAL DUE TO BANKS		1349	1670	1950	3423	2751	949
Principal		325	877	1195	2786	2320	653
Interest		1025	793	755	638	431	297
TOTAL DUE TO OTHERS		712	864	869	816	664	487
Principal		224	492	504	447	302	112
Interest		488	372	365	369	362	375
TOTAL DUE TO UNSPECIFIED CREDITORS		0	102	461	911	1597	2692
Principal		0	0	0	0	0	279
Interest		0	102	460	911	1597	2413
Arrears		0	0	0	0	0	0
TOTAL FINANCING GAP		0	0	0	0	0	0
Of which unpaid interest*		-548	-3169	-2928	-4450	-3941	-2956
TOTAL PAYMENT CAPACITY		3093	5863	5799	7694	7640	7267
I)EARNED		1700	1500	1540	1582	1625	1670
a) Trade Balance		1000	1000	1040	1082	1125	1170
Exports**		5620	5800	6032	6273	6524	6785
Imports**		4620	4800	4992	5192	5399	5615
b) Services and Tranfers, net (excluding interest)		600	400	400	400	400	400
c) Interest Earnings		100	100	100	100	100	100
II)BORROWED***		1393	4363	4259	6112	6015	5597
a)New Credits (Medium & Long Term)		200	290	650	950	950	950
b)Short Term Credits & Recycled Interest, Net		200	100	100	100	100	100
c)Rescheduling Agreements		993	3973	3509	5062	4965	4547
TOTAL DEBT	28200	29045	30239	31570	33232	35305	37947
Of which new borrowed		1393	5756	10015	16127	22142	27739
Libor Rate		8.5%	6.8%	7.5%	8.6%	9.4%	10.4%

Footnotes:
* Negative values for unpaid interest equal the extent to which payment capacity exceeds interest due and can be applied to repayments of principal.
** Exports and Imports are estimated to grow by 4 percent beginning in 1987.
*** Terms for the repayment of new borrowings and reschedulings were assumed to be a 5 year grace and a 5 year principal repayment period.

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TABLE 4
SENSITIVITY ANALYSIS, MILLION US DOLLARS AS OF 1/13/86
SCENARIO: BASELINE (CIA ESTIMATES) AND RESCHEDULING OF FINANCING GAPS

Years	1985	1986	1987	1988	1989	1990
TOTAL DEBT*						
Baseline LIBOR	29045	30239	31570	33232	35305	37947
Baseline LIBOR + 1%	29045	30533	32205	34257	36796	39998
Baseline LIBOR + 2%	29045	30826	32846	35301	38328	42126
Baseline LIBOR + 3%	29045	31120	33492	36365	39904	44333
AMOUNT OF ADDITIONAL DEBT						
Between LIBOR & LIBOR + 1%	0	294	635	1025	1491	2051
Between LIBOR + 1% & LIBOR + 2%	0	294	641	1044	1533	2128
Between LIBOR + 2% & LIBOR + 3%	0	294	647	1064	1575	2208
RESCHEDULING AGREEMENTS*						
Baseline LIBOR	993	3973	3509	5062	4965	4547
Baseline LIBOR + 1%	993	4267	3850	5452	5431	5107
Baseline LIBOR + 2%	993	4561	4196	5857	5918	5703
Baseline LIBOR + 3%	993	4854	4550	6273	6431	6334
AMOUNT OF ADDITIONAL FUNDS						
Between LIBOR & LIBOR + 1%	0	294	341	390	466	560
Between LIBOR + 1% & LIBOR + 2%	0	294	346	405	487	596
Between LIBOR + 2% & LIBOR + 3%	0	293	354	416	513	631
TOTAL DEBT **						
Baseline Export Projection	29045	30239	31570	33232	35305	37947
Baseline Export Projection + 1%	29045	30183	31392	32855	34636	36871
Baseline Export Projection + 2%	29045	30127	31213	32473	33954	35769
Baseline Export Projection + 3%	29045	30070	31033	32086	33259	34639
AMOUNT OF ADDITIONAL DEBTS						
Between B.E.P. & B.E.P. + 1%	0	-56	-178	-377	-669	-1075
Between B.E.P. + 1% & B.E.P. + 2%	0	-56	-179	-382	-682	-1102
Between B.E.P. + 2% & B.E.P. + 3%	0	-56	-180	-387	-695	-1130
RESCHEDULING AGREEMENTS**						
Baseline Export Projection	993	3973	3509	5062	4965	4547
Baseline Export Projection + 1%	993	3917	3387	4863	4673	4140
Baseline Export Projection + 2%	993	3861	3264	4660	4373	3720
Baseline Export Projection + 3%	993	3805	3140	4453	4065	3285
AMOUNT OF ADDITIONAL FUNDS						
Between B.E.P. & B.E.P. + 1%	0	-56	-122	-199	-292	-407
Between B.E.P. + 1% & B.E.P. + 2%	0	-56	-123	-203	-300	-420
Between B.E.P. + 2% & B.E.P. + 3%	0	-56	-124	-207	-308	-435

Footnotes:
* Assuming changes in LIBOR beginning in 1986.
** Assuming changes in export growth beginning in 1986.

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TABLE 5
POLAND: PAYMENTS DUE TO CREDITORS IN MILLION US DOLLARS AS OF 1/13/86
SCENARIO: OPTIMISTIC (POLISH ESTIMATES)

Years	Terms	1985	1986	1987	1988	1989	1990
TOTAL PAYMENTS DUE TO CREDITORS		3093	6440	8825	11858	13266	12296
TOTAL PRINCIPAL DUE		549	2659	2928	4450	3942	2763
TOTAL INTEREST DUE		2545	2668	2787	3073	3406	3847
TOTAL ARREARS		0	1113	3110	4335	5918	5686
TOTAL DUE TO GOVERNMENTS		1032	3228	2519	2543	2628	3139
Principal		0	1290	1229	1218	1320	1912
Interest		1032	1428	1290	1326	1309	1227
Arrears		0	510	0	0	0	0
TOTAL DUE TO BANKS		1349	1670	1950	3423	2751	949
Principal		325	877	1195	2786	2320	653
Interest		1025	793	755	638	431	297
TOTAL DUE TO OTHERS		712	864	869	816	664	487
Principal		224	492	504	447	302	112
Interest		488	372	365	369	362	375
TOTAL DUE TO UNSPECIFIED CREDITORS		0	679	3487	5076	7222	7721
Principal		0	0	0	0	0	86
Interest		0	75	377	741	1304	1950
Arrears		0	603	3110	4335	5918	5686
TOTAL FINANCING GAP		603	3110	4335	5918	5686	4466
Of which unpaid interest*		55	-662	-1703	-2867	-4174	-3983
TOTAL PAYMENT CAPACITY		2490	3330	4490	5940	7580	7830
I)EARNED		2060	2160	2280	2500	2630	2770
a) Trade Balance		1270	1540	1660	1780	1910	2050
Exports		5650	6170	6620	7100	7620	8180
Imports		4380	4630	4960	5320	5710	6130
b) Services and Tranfers, net (excluding interest)		670	500	500	600	600	600
c) Interest Earnings		120	120	120	120	120	120
II)BORROWED**		430	1170	2210	3440	4950	5060
a)New Credits (Medium & Long Term)		280	970	2010	3140	4650	4660
b)Short Term Credits & Recycled Interest, Net		150	200	200	300	300	400
TOTAL DEBT	28200	28685	29193	29700	30273	31049	32126
Of which new borrowed		430	1600	3810	7250	12200	17260
Libor Rate		8.5%	6.8%	7.5%	8.6%	9.4%	10.4%

Footnotes:
* Negative values for unpaid interest equal the extent to which payment capacity exceeds interest due and can be applied to repayments of principal.
** Terms for the repayment of new borrowings were assumed to be a 5 year grace and a 5 year principal repayment period.

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TABLE 6
SENSITIVITY ANALYSIS, MILLION US DOLLARS AS OF 1/13/86
SCENARIO: OPTIMISTIC (POLISH ESTIMATES)

Years	1985	1986	1987	1988	1989	1990
TOTAL DEBT*						
Baseline LIBOR	28685	29193	29700	30273	31049	32126
Baseline LIBOR + 1%	28685	29483	30320	31264	32471	34058
Baseline LIBOR + 2%	28685	29773	30947	32273	33935	36065
Baseline LIBOR + 3%	28685	30063	31579	33302	35440	38149
FINANCING GAP*						
Baseline LIBOR	603	3110	4335	5918	5686	4466
Baseline LIBOR + 1%	603	3400	4955	6909	7108	6398
Baseline LIBOR + 2%	603	3690	5582	7919	8572	8405
Baseline LIBOR + 3%	603	3980	6214	8947	10077	10489
AMOUNT OF ADDITIONAL DEBT OR GAP						
Between LIBOR & LIBOR + 1%	0	290	621	991	1423	1932
Between LIBOR + 1% & LIBOR + 2%	0	290	626	1010	1464	2007
Between LIBOR + 2% & LIBOR + 3%	0	290	632	1029	1505	2084
TOTAL DEBT **						
Baseline Export Projection	28685	29193	29700	30273	31049	32126
Baseline Export Projection + 1%	28685	29136	29516	29873	30322	30934
Baseline Export Projection + 2%	28685	29080	29331	29468	29583	29712
Baseline Export Projection + 3%	28685	29023	29145	29059	28829	28460
FINANCING GAP**						
Baseline Export Projection	603	3110	4335	5918	5686	4466
Baseline Export Projection + 1%	603	3053	4151	5519	4959	3273
Baseline Export Projection + 2%	603	2997	3966	5114	4220	2051
Baseline Export Projection + 3%	603	2940	3779	4704	3466	800
AMOUNT OF ADDITIONAL DEBT OR GAP						
Between B.E.P. & B.E.P. + 1%	0	-56	-184	-400	-726	-1192
Between B.E.P. + 1% & B.E.P. + 2%	0	-57	-185	-405	-740	-1222
Between B.E.P. + 2% & B.E.P. + 3%	0	-57	-186	-410	-753	-1252

Footnotes:
* Assuming changes in LIBOR beginning in 1986.
** Assuming changes in export growth beginning in 1986.

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Attachment 2

Figure 1 and an article assessing Polish Export Potential

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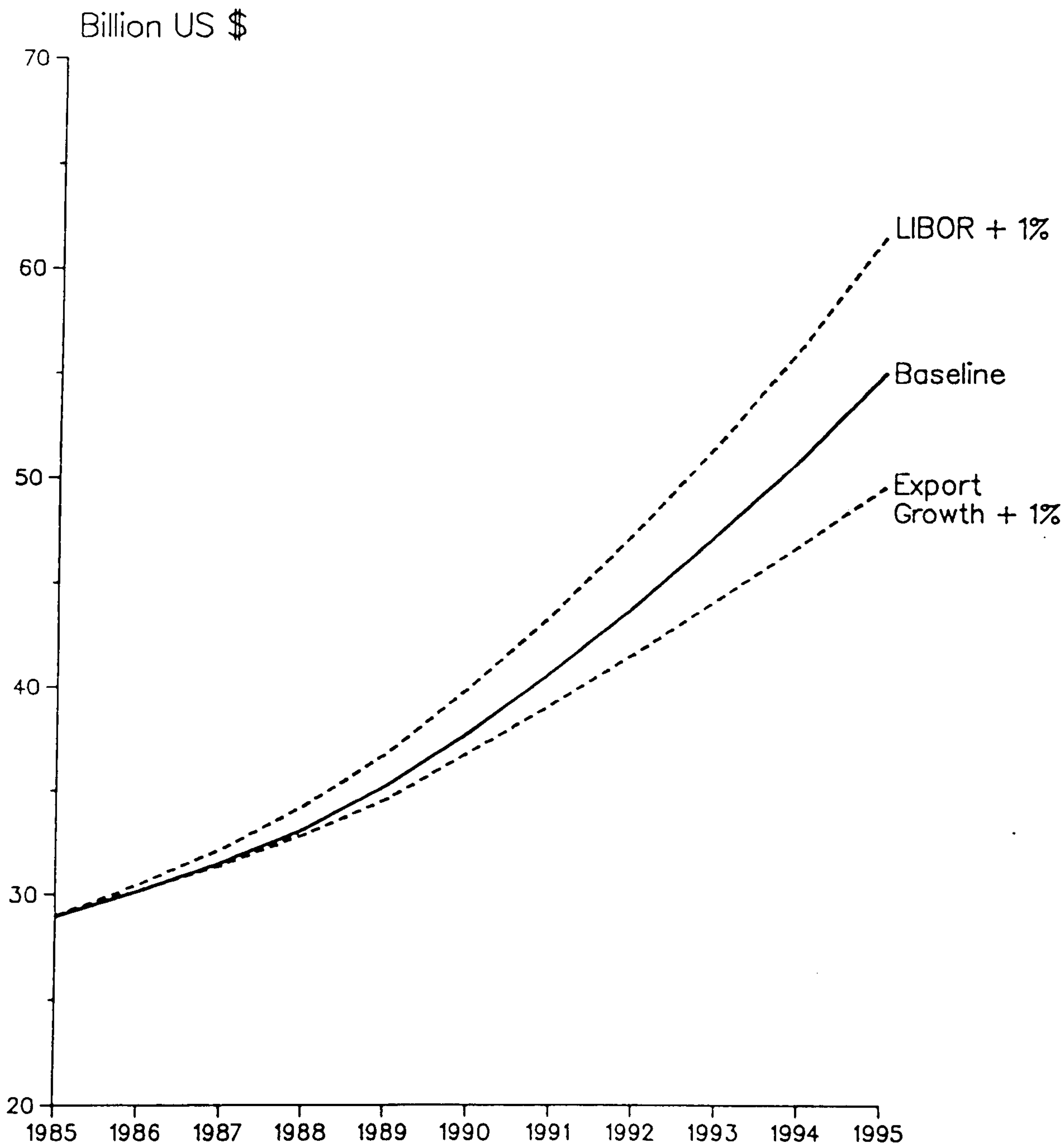
FIGURE 1

POLAND: Gross Debt In The Baseline Scenario And Sensitivity Analysis.



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Poland: Dim Prospects for Increasing Hard Currency Earnings

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One of the Polish Government's primary goals over the next five years is to increase hard currency earnings, but given the lack of effective export promotion policies any significant increase is unlikely. Incentives to export are few, and the regime does not channel adequate investment to those industries that are potential hard currency earners. The regime may tinker with its policies, but internal pressures to increase consumption rather than exports and weak Western demand for Polish products are likely to thwart any major export campaign.

Poland: Export Incentive Policies

Hard Currency Retention Funds:
- *Permit firms to keep an average 20 percent of export earnings to fund imports.*
- *Restrict purchases to raw materials and capital equipment essential to export production.*
- *Are held by 40 percent of firms.*
- *Financed 15 percent of imports in 1984.*

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Foreign Trade Rights:
- *Allow firms to conduct trade directly without the aid of foreign trade organizations.*
- *Have been granted to about 300 firms.*
- *Accounted for about 7 percent of exports in 1984.*

Foreign Exchange Export Credit System:
- *Allows firms to obtain loans from Bank Handlowy, the foreign trade bank, to purchase the machinery and equipment necessary to develop hard currency exports.* 25X1
- *Funded 0.5 percent of imports in 1984, but probably about 2 percent in 1985.*

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Inadequate Export Incentives

The 3-percent decline in hard currency exports in the first nine months of 1985 compared with the same period in 1984 partly reflects Warsaw's ineffective export policy. There is little incentive to export or to introduce quality products given high domestic demand. In a recent survey, more than 40 percent of all firms expressed no interest in exporting. With easier and more profitable sales available on the domestic market, few firms are willing to undertake costly overseas marketing.

The regime has not carried through on its economic reform policy, which—at least on paper—tied a firm's imports of Western raw materials and capital equipment to its export revenues. Central allocations of export funds remain the most common method for financing imports as the programs designed to promote exports have faltered:

- The hard currency retention fund—intended to finance more than half of all hard currency imports—had little impact because the share of hard currency earnings that may be retained is too small to encourage most firms to accept the difficulties of becoming an exporter.
- The program to grant enterprises foreign trade rights has not succeeded because most firms find it easier to deal with foreign trade organizations that possess the foreign trading skill, trained personnel, and networks of established markets they lack. In addition, the Ministry of Foreign Trade excludes firms from entering markets in which foreign trade organizations already operate.
- The foreign exchange export credit system receives little use by firms because of the high interest rates charged on the limited funds available.

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Several other policies limit export incentives. The National Bank of Poland, for example, recently failed to implement a promised reduction in the high taxes levied on hard currency earners. The regime also delayed a reform tying wage hikes to increases in exports.

Despite inadequate export performance, some officials have opposed additional export incentives, especially further devaluations of the zloty. The zloty has been devalued from 80 to 159 to the dollar in the last four years, but many Polish economists believe a rate of about 600 to the dollar is required to bring domestic prices in line with world prices. The regime probably is reluctant to devalue, however, because of the inflationary impact and concern that increased exports would depress consumer supplies.

Poland: Hard Currency Exports in 1984

Percent

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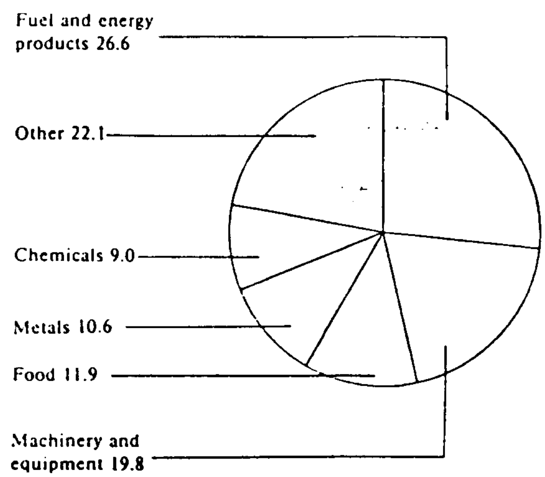

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Lack of Export Options

Even with more effective policies, Poland is not well positioned in markets with high growth potential. More than three-fourths of Polish hard currency in 1984 was earned through exports of coal, copper and other metals, machinery and parts, chemicals, and processed food. Warsaw's plans to increase exports to the West by 7 percent annually in 1986-90 appear excessively optimistic, given prospects in its leading export markets:

- Even the Poles see marginal growth potential for the extractive industries in the next five years. Output of coal, copper, and sulfur will stagnate, and production costs will escalate due to past inadequate investment. Moreover, pleas to conserve fuels and raw materials have been largely ignored. Stagnant demand for many raw materials on the world market, competition from other suppliers, and possible protectionist measures by West Europeans also may constrain sales of these products.

- Plans to increase exports of processed foods, especially meat, at rapid rates during 1986-90 hinge on increased production, reversal of past neglect of storage, packaging, and transport facilities, and the development of improved marketing strategies. Increasing meat exports, however, risks consumer protests against draining domestic supplies. Moreover, agricultural exports are vulnerable to the uncertainties of weather and Western import restrictions.

- A rapid expansion of exports of higher priced specialty chemicals is targeted at foreign high-growth industries, such as electronics, pharmaceuticals, fertilizers, and pesticides. The economic plan, however, does not provide the investments needed to increase output of these goods.

- Past experience suggests that Warsaw's plans to boost exports of machinery and spare parts in the next five years will prove unrealistic. In the first nine months of 1985, exports of machinery to the West were only 50 percent of the annual plan. Moreover, the newly industrialized countries, with better quality control and marketing channels than Poland, sell the same low-technology

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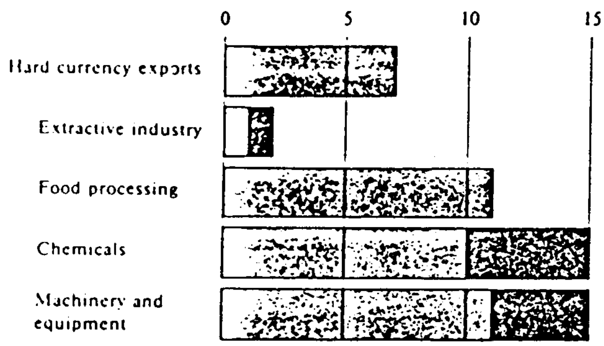
Poland: Planned Growth of Hard Currency Exports, 1986-90

Average annual percent increase

Shaded portion represents a range



machinery. Failure to develop new products, import new industrial components on a large scale, and buy production licenses from Western firms, have widened Poland's technology gap and will continue to hamper export competitiveness.

Exports of services also will show little improvement for hard currency earnings beyond the $400 million earned in 1984. Warsaw hopes for substantial future growth in tourism earnings, but considerable investment in hotels and services is required. Most tourist agencies agree that Polish prices are high compared to other East European countries and accommodations and services fall below Western standards. While the export of construction services has some potential, given a revival of investment in the Third World, Warsaw must adapt better to demand and develop an area of expertise. Poland's geographic location offers potential for increasing transit services, but investment and marketing are required. The outlook for the export of technical know-how is even less promising—Poland's outdated technology base produces few patents that are licensed on a world basis. For example, less than 2 percent of all Polish inventions have foreign patents compared to 10 percent of East German and 60 percent of Dutch inventions.

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Outlook

We expect Poland's hard currency export earnings to increase marginally at best in the next five years. The regime shows no signs that it will redirect investment funds from outdated projects to those industries with the most hard currency export earning potential or greatly increase export incentives for firms. Nor does a drastic devaluation appear in the offing because of regime fears of a negative public reaction to large increases in domestic prices.

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The regime's proposed export incentives are unlikely to bring major improvement. For example, Warsaw plans to establish a Foreign Trade Development Bank to provide loans for developing potential exports, to raise a firm's share under the hard currency retention fund, and to grant tax and tariff concessions. The Poles also are encouraging joint ventures with the West, especially in the metals and machinery sectors, but Western firms appear reluctant to participate due to past problems and government policies. In addition, prospects for renewing old contracts, which nearly all expire by 1987, are gloomy because Western companies are phasing out the older products now made in cooperation with Poland.

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Domestic pressure to increase consumption more than exports to either the West or East is another major impediment to export growth. As in the past, the regime probably will yield to consumer demands and permit consumption to grow by more than the 2-percent annual rate planned for the next five years. Such concessions would mean even less

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Contradictory Export Policies

The Polish Government has not conducted an effective export campaign, and at times its actions have had an unintended opposite effect. For example, the regime in 1985:

- *Ordered an exporter of light bulbs to decrease sales abroad by $2 million because of domestic needs.*
- *Denied permission for a dairy to process and export long-life milk because the equipment to process the milk was leased from a Western firm rather than purchased outright.*
- *Delayed for almost two years expansion on abandoned property of a factory producing air gliders, resulting in a $100,000 loss in export revenue and penalties for breach of contract to Western importers.*

Although behavior in these examples appears irrational, in each case the regime made these decisions by focusing on other priorities, especially consumer needs. 25X1

export revenue to repay the debt. Despite creditor demands to increase export revenues, their lack of leverage over Poland means the regime most likely will ignore the protests. 25X1

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